

Message Text

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INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-05 H-01 INR-10
L-03 NSAE-00 NSC-05 PA-01 SP-02 SS-15 ICA-11
CEA-01 STR-07 AID-05 COME-00 EB-08 FRB-03 XMB-02
OPIC-03 LAB-04 SIL-01 OMB-01 /101 W
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R 110925Z AUG 78
FM AMEMBASSY ROME
TO SECSTATE WASHDC 4842
TREASURY DEPT WASHDC
INFO AMEMBASSY BRUSSELS
AMCONSUL FLORENCE
AMCONSUL GENOA
AMCONSUL MILAN
AMCONSUL NAPLES
AMCONSUL PALERMO
AMCONSUL TRIESTE UNN
AMCONSUL TURIN UNN

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PASS FRB; USEEC

E.O. 11652: N/A
TAGS: EFIN, ECON, ELAB, IT
SUBJ: LITTLE PROGRESS ON THREE-YEAR ECONOMIC PLAN AND EXPENDI-
TURE LIMITATION, BUT SOME MEASURES TAKEN IN BUILDING
SECTOR AND ON FINANCIAL CRISIS IN CHEMICAL SECTOR

REF: A. ROME 12427, B. ROME A-159, C. ROME 12590

SUMMARY. DESPITE CONTINUING SERIES OF MEETINGS
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INVOLVING GOVERNMENT, POLITICAL PARTIES, LABOR
AND MANAGEMENT, NO CONSENSUS HAS BEEN REACHED ON
POLICIES TO CONTROL PUBLIC EXPENDITURES (DISCUSSION
HAS CENTERED ON REFORM OF PENSION SYSTEM) OR ON
TREASURY MINISTER PANDOLFI'S THREE-YEAR ECONOMIC PLAN.
DETAILED PRESENTATION OF PLAN IS SCHEDULED FOR THE
END OF AUGUST; DEADLINE FOR DECISIONS SET FOR END

SEPTEMBER. AT SAME TIME, THERE HAS BEEN SOME ACTION. THE GOVERNMENT HAS INSTITUTED PROGRAM FOR PROMPT INVESTMENT OF 1,000 BILLION LIRE IN PUBLIC WORKS AND HAS TAKEN STEPS TO CHECK THE MOUNTING FINANCIAL CRISIS IN THE CHEMICAL INDUSTRY. IN ADDITION, PARLIAMENT RECENTLY PASSED TWO MEASURES AIMED AT REKINDLING SOME LIFE IN THE MORIBUND HOUSING FIELD. END SUMMARY.

1. DISCUSSION OF ECONOMIC POLICY HAS BEEN LARGELY SUBSUMED IN CONSIDERATION OF THREE-YEAR (1979-81) ECONOMIC PLAN, WHICH PANDOLFI HAS PROMISED FOR PAST SEVERAL MONTHS. LATEST IN SERIES OF MEETINGS ON THIS SUBJECT--INVOLVING GOVERNMENT, POLITICAL PARTIES, LABOR AND MANAGEMENT--WAS GATHERING OF ECONOMIC EXPERTS FROM THE POLITICAL PARTIES ON AUGUST 4, AT WHICH AN AGREEMENT WAS REACHED IN PRINCIPLE ON THE PLAN'S GOALS: A REDUCTION IN THE PUBLIC SECTOR DEFICIT AND INFLATION AND AN INCREASE IN INVESTMENT AND GDP GROWTH. HOWEVER, PROPOSED MEASURES FOR ATTAINING THESE GOALS WERE NOT PRESENTED AT THE MEETING; INSTEAD, THE GOVERNMENT PROMISED TO CIRCULATE A PLAN DOCUMENT BY THE END OF AUGUST IN THE EXPECTATION THAT THE NECESSARY CONSENSUS CAN BE ACHIEVED IN SEPTEMBER. IN ANY CASE, THE GOVERNMENT IS REQUIRED BY LAW TO PRESENT THE 1979 BUDGET AND THE THREE YEAR ECONOMIC PLAN TO PARLIAMENT BY SEPTEMBER 30. LIMITED OFFICIAL USE

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2. A KEY ELEMENT IN THE DELIBERATIONS ON ECONOMIC POLICY IS THE AGREED NECESSITY TO REDUCE THE PUBLIC SECTOR DEFICIT AS A SHARE OF GDP. TO ACHIEVE THIS, HOWEVER, THE WAY PENSION AND OTHER GOVERNMENT TRANSFER PAYMENTS ARE LINKED TO COST-OF-LIVING INCREASES WILL PROBABLY HAVE TO BE ALTERED, SINCE THIS LINK, IN ITS PRESENT FORM, IS THE MOST IMPORTANT FACTOR CURRENTLY INCREASING GOVERNMENT EXPENDITURE. HOWEVER, THE UNIONS, NOT SURPRISINGLY, REACTED STRONGLY WHEN PANDOLFI SURFACED SOME (PERHAPS PRELIMINARY) IDEAS FOR CURBING PENSION INCREASES (REF C). THE PRESENT COST-OF-LIVING WAGE ESCALATOR MECHANISM IS ANOTHER INSTITUTION THAT HAS BEEN MUCH CRITICIZED FOR ITS ADVERSE EFFECTS ON ECONOMIC STABILITY, BUT PRIME MINISTER ANDREOTTI SAID RECENTLY IN A TELEVISION INTERVIEW THAT HE SAW LITTLE HOPE FOR ALTERING THIS MECHANISM BECAUSE OF UNION OPPOSITION. THE OTHER SIDE OF THE COIN FOR THE UNIONS IS JOB CREATION. HOWEVER, IN THIS AREA THE DISCUSSION HAS BEEN VERY CONFUSED, WITH SOME GOVERNMENT CLAIMS THAT AS MANY AS 900,000 NEW JOBS WILL BE CREATED UNDER THE THREE-YEAR PLAN (IMMEDIATELY--AND RIGHTLY--GREATED WITH

OVERWHELMING SUSPICION), WHILE OTHER, LOWER FIGURES HAVE BEEN FLOATED WITH EQUAL ABANDON.

3. DESPITE LACK OF SUCCESS IN FORMULATING BASIC ECONOMIC POLICIES, GOVERNMENT HAS TAKEN SOME LIMITED ACTIONS. IT INTENDS TO INVEST 1,000 BILLION LIRE IN HIGHWAYS AND PUBLIC CONSTRUCTION, ABOUT HALF OF WHICH WOULD BE IN THE SOUTH. THE CONSTRUCTION PROJECTS COVER HIGHWAYS (EXCLUSIVE OF SUPERHIGHWAYS), PUBLIC BUILDINGS, AND PORTS AND ARE INTENDED TO CREATE 70 TO 80 THOUSAND NEW JOBS. PUBLIC WORKS MINISTER STAMMATI IS ALSO DRAFTING LEGISLATION FOR A SCHEME TO CHANNEL THE PROCEEDS OF A SPECIAL ISSUE OF INDEXED SECURITIES INTO SUBSIDIZED MORTGAGES, THEREBY STIMULATING DEMAND FOR HOUSING.
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4. PARLIAMENT ALSO RECENTLY PASSED TWO LAWS IN THE HOUSING AREA: THE "FAIR-RENT" LAW AND A TEN-YEAR REAL ESTATE PLAN. THE "FAIR-RENT" LAW ENDED A RENT FREEZE THAT HAD GENERALLY BEEN IN EFFECT FOR 40 YEARS. THE "FAIR RENT" LAW PROVIDES FOR ONLY A VERY GRADUAL TRANSITION (OVER A PERIOD OF 6 YEARS) TO A SOMEWHAT FREER HOUSING MARKET. LIMITED OFFICIAL USE

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THE TEN-YEAR PLAN FOR HOUSING CONSTRUCTION, WITH PLANNED EXPENDITURE OF 4,000 BILLION LIRE DURING PERIOD 1978-81, WITH WHICH 80,000 NEW DWELLING UNITS ARE SUPPOSED TO BE BUILT EACH YEAR.

5. IN THE INDUSTRIAL SECTOR, PARLIAMENT RECENTLY PASSED A LAW PROVIDING FOR "CONTROLLED ADMINISTRATION" OF FIRMS THAT WOULD HAVE OTHERWISE, UNDER THE PREVIOUS LAW, GONE BANKRUPT. UNDER "CONTROLLED ADMINISTRATION" THE GOVERNMENT WILL APPOINT A "COMMISSIONER" WHO WILL ATTEMPT TO SALVAGE THE FIRMS IN QUESTION THROUGH BOTH REAL AND FINANCIAL RESTRUCTURING. THE LAW IS AIMED MAINLY AT THE LARGE CONGLOMERATES IN THE CHEMICAL SECTOR. IT SEEMS LIKELY THE NEW LAW WILL PROMPT THE BANKS AND SPECIAL CREDIT INSTITUTES TO TAKE SOME INITIATIVE IN BAILING OUT FIRMS IN DIFFICULTY, AND THEREBY AVOID THE APPOINTMENT OF A "COMMISSIONER." INDEED, BANKING CONSORTIA, ORGANIZED WITH GOVERNMENT ENCOURAGEMENT, HAVE JUST ARRANGED NEW CREDIT PACKAGES FOR THE TWO MAJOR CHEMICAL GROUPS IN FINANCIAL DIFFICULTY--LIQUIEHIMICA AND SIR. "CONTROLLED ADMINISTRATION" MAY BE HAMPERED, HOWEVER, BY THE LACK OF A FINANCIAL RESTRUCTURING LAW (REF B) ON WHICH IT DEPENDS HEAVILY. FINANCIAL RESTRUCTURING WOULD PROVIDE INTEREST SUBSIDIES OR TAX RELIEF TO BANKS ENGAGED IN FINANCIAL SALVAGING OPERATIONS.

7. COMMENT. OF THE GOVERNMENTAL AND LEGISLATIVE ACTIONS TAKEN JUST BEFORE THE AUGUST VACATION, THE DECISION TO START SPENDING ALMOST IMMEDIATELY 1,000 BILLION LIRE ON PUBLIC WORKS COULD HAVE THE GREATEST IMPACT. FIRST, BECAUSE THE LEAD TIME IS SHORT, THIS MONEY MAY ACTUALLY BE SPENT. SECONDLY, THESE TYPES OF PROJECTS SHOULD HAVE A PERCEPTIBLE IMPACT ON EMPLOYMENT

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IN THE SOUTH, WHERE THEY WILL BE CONCENTRATED, AT RELATIVELY LITTLE COST IN TERMS OF IMPORTS. BY CONTRAST, THE TEN-YEAR PLAN FOR THE HOUSING SECTOR RISKS FOLLOWING SO MANY OTHER ELABORATE ECONOMIC PLANS TO OBLIVION.

7. THE EFFECTS OF FURTHER GOVERNMENT INTERVENTION, OR THE THREAT OF GOVERNMENT INTERVENTION, IN THE CHEMICAL SECTOR IS NOT CLEAR. CERTAINLY BANKRUPTCY IS APPROPRIATE FROM A STRICTLY ECONOMIC POINT OF VIEW IN MANY CASES. HOWEVER, THERE ARE SERIOUS POLITICAL AND SOCIAL OBSTACLES TO CUTTING BACK OPERATIONS AND, PARTICULARLY, TO FIRING WORKERS. IN ADDITION, SOME OF THE CHEMICAL CONGLOMERATES IN FINANCIAL DIFFICULTY HAVE PROFITABLE ACTIVITIES, AND IT IS UP TO THE CREDITORS OR, AT LAST RESORT, THE "COMMISSIONER," TO SORT THESE OUT FOR SEPARATE TREATMENT. IT DOES NOT SEEM THAT THE KIND OF INTERVENTION GENERALLY CONTEMPLATED, E.G., RESCHEDULING OF DEBTS TO BANKS, WOULD NECESSARILY HAVE AN IMPACT ON TOTAL LIQUIDITY, ALTHOUGH IT MIGHT REDISTRIBUTE AVAILABLE CREDIT TO THE DISADVANTAGE OF OTHER, PERHAPS MORE PRODUCTIVE, INDUSTRIES, AS NOTED BY CARLI.

8. REGARDING THE THREE-YEAR ECONOMIC PLAN OF TREASURY MINISTER PANDOLFI, THERE HAS BEEN CONTINUAL REFERENCE IN THE PRESS TO WHERE THE ITALIAN ECONOMY SHOULD BE HEADED BUT VERY FEW DETAILS HAVE SURFACED ON HOW THE POLICYMAKERS PLAN TO GET IT THERE; AND YET THE GOVERNMENT NEEDS TO OBTAIN SUFFICIENT CONSENSUS, PARTICULARLY AMONG THE UNIONS AND THE POLITICAL PARTIES, ON ISSUES, SUCH AS PENSIONS AND COST OF LABOR, IN ORDER TO TRANS-LATE THE MOST URGENT ELEMENTS OF THE PLAN INTO DRAFT LEGISLATION BY SEPTEMBER 30. THIS TIMING IS PROBABLY NOT TENABLE. HOLMES

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